



July 13, 2018

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Via e-mail: regs.comments@federalreserve.gov

Re: Regulatory Capital Rules: Implementation and Transition of the Current Expected Credit Losses Methodology for Allowances and Related Adjustments to the Regulatory Capital Rules and Conforming Amendments to Other Regulations (FRB Docket No. R-1605 and RIN 7100 AF-04)

Dear Ms. Misback:

SunTrust Banks, Inc. ("SunTrust") appreciates the opportunity to comment on the Agencies' notice of proposed rulemaking regarding implementation and transition of the Current Expected Credit Losses ("CECL") methodology. SunTrust supports the Agencies' proposal of a transition period, as well as delaying the implementation of CECL into stress testing until after the 2019 cycle. However, given the significance of this change and the potential for disruption in the banking industry and the broader economy, we believe the Agencies need to take further action to adjust regulatory capital rules in response to the new reserving requirements.

CECL is a significant change to the accounting rules for determining the allowance for credit losses ("Allowance") for certain financial assets including loans held for investment. For most banks, CECL is expected to increase the Allowance given the change from an "incurred loss" reserve to reserving for lifetime expected credit losses. A higher Allowance results in a decrease in retained earnings, which is a key component of regulatory capital. Additionally, the Allowance will fluctuate in response to "reasonable and supportable" forecasts, subjecting the Allowance to significant variability when expectations of future economic conditions change. This, in turn, will drive increased variability in regulatory capital levels.

Other observations regarding the impact of CECL include:

- CECL will result in greater procyclicality given the inability to accurately predict turning points in the business cycle. This tendency was noted in an empirical analysis of the effects of CECL performed by The Clearing House¹. That study

¹ Francisco Covas and William Nelson, The Clearing House, *Staff Working Paper 2018-1 – Current Expected Credit Loss: Lessons from 2007-2009* (July 2018).

found that in the most recent crisis, had CECL been in place, capital ratios would have been 160 basis points lower in the third quarter of 2008. Faced with that prospect, strong incentives would have existed for banks to reduce lending at the worst point of the crisis, thereby exacerbating problems with the broader economy.

- CECL is likely to impact the price, availability and structure of credit because of the requirement to recognize lifetime expected credit losses at the inception of a loan and the aforementioned volatility in the Allowance; these effects will likely be more acute for certain products such as residential mortgages.
- CECL represents an implicit increase in capital requirements that will result in unnecessarily high levels of effective capitalization.

In view of these challenges and potentially harmful effects to the broader economy, we recommend that the Agencies:

- Make CECL implementation capital neutral;
- Allow a five-year transition period;
- Delay the implementation of CECL into CCAR/DFAST stress testing until the 2021 testing cycle; and
- Perform a quantitative impact study before final implementation of CECL.

Make CECL implementation capital neutral

SunTrust believes capital rules should be designed to measure the amount of total loss absorbing capacity required for an institution, which should include consideration of both capital instruments and the Allowance². Today, the regulatory capital framework is calibrated based on the incurred loss methodology. Upon implementation of CECL, additional credit loss reserves will be available to absorb losses that would otherwise reduce Common Equity Tier 1 (“CET1”). To reflect the impact of additional reserves, a permanent change to the regulatory capital framework is needed to compensate for the amount of incremental loss absorbing capacity.

We would prefer that the entire Allowance be treated as CET1 given its loss absorbing capacity and our understanding that many investors and rating agencies view capital and

² While capital is available to absorb a variety of risks, and the Allowance is only available to absorb credit risk, both contribute to total loss absorbing capacity.

credit loss reserves as fungible, enterprise-sustaining resources. However, we acknowledge that this approach may not be fully aligned with current regulatory capital constructs.

We believe that several of the alternatives developed by banking industry trade groups³ and others⁴ are reasonable approaches to address the impact of CECL on regulatory capital. We recommend the Agencies consider the following as potential means to foster capital neutrality:

- Allow symmetrical additions and deductions to CET1 based on the variance between CECL reserves and a one-year regulatory expected loss (EL) amount. For example, if CECL reserves are greater than a one-year regulator-defined EL, then the excess would be added to CET1. The concept of a one-year regulatory EL is already established for advanced approaches banks, but a framework would have to be developed to determine regulatory EL by risk-weighted asset category for standardized approach banks. We believe that a standardized EL based on one year of historical through-the-cycle losses by asset category would be appropriate.
- Alternatively, minimum capital requirements could be reduced to achieve a similar outcome.
- A capital neutral approach would address capital requirement inconsistencies between U.S and international banks. CECL will result in U.S. banks holding higher Allowances than their international peers, which puts U.S. banks at a competitive disadvantage. We believe that a change in the U.S. regulatory capital framework that considers the incremental loss absorbing capacity of the Allowance under CECL would help level the international playing field.

SunTrust would welcome the opportunity to work with the Agencies to develop and refine an approach to neutralize the effect of CECL on regulatory capital.

Allow a five-year transition period

We have observed significant uncertainty regarding the impact of CECL based on our implementation activities to date and discussions with our peers and industry groups. Ultimately, the impacts will depend on each bank's underlying loan portfolio and credit quality, judgments and assumptions used in developing the estimate, and forecasted economic conditions. Additionally, the Agencies have expressed expectations that CECL

³ The American Bankers Association, The Clearing House Association, L.L.C. and the Financial Services Roundtable. We have been involved with and are supportive of these organizations' responses to the proposal.

⁴ In particular, Deloitte, and their 2018 publication "Capital and the Allowance for Credit Losses".

methodologies will continue to develop over a period of time subsequent to implementation⁵. Due to the complex interactions of these factors and the lack of empirical analysis on the “real-world” impacts, we believe that three years is an insufficient amount of time to adequately understand and address the impacts of CECL, and that five years is a more appropriate transition period.

A transition period should be allowed even if the Agencies work towards a capital neutral implementation approach because, in real world application, changes made to the regulatory capital framework may not be capital neutral for all banks.

Delay implementation of CECL into CCAR/DFAST stress testing until the 2021 testing cycle

The implementation of CECL into the CCAR/DFAST stress testing exercises would be extremely burdensome from an operational perspective if separate CECL estimates are required for each quarter of the forecast horizon. Such an approach would also provide unrealistic results since the economic forecast variables are known at the outset (i.e., the use of a “perfect foresight” approach). Further, there could be cross-cutting issues with the Agencies’ proposed stress buffer requirements and other potential future changes⁶ that we think should be considered when developing the approach for implementation of CECL⁷.

Due to these significant challenges, we believe incorporation of CECL into stress testing should be delayed until the 2021 cycle and we also request that the Agencies provide implementation guidance to promote clear and consistent application for banks involved in the process.

We welcome the opportunity to work with the Agencies to develop a simplified, transparent and consistent approach to this issue.

Perform a quantitative impact study before final implementation of CECL

Prior to implementation of CECL and finalization of the related rulemaking, SunTrust believes the Agencies should perform a quantitative impact study that evaluates the potential through-the-cycle effects of CECL on bank capital, as well as lending and economic activity. We welcome the opportunity to participate in such an analysis. We believe that the study would support the argument for a capital neutral approach.


⁵ According to the Federal Reserve Board’s December 2016 CECL FAQ, Question 7, “After the effective date of CECL, the agencies will assess the implementation of the accounting standard and consider the need to issue additional supervisory guidance to aid in the development of practices for the sound application of the standard.”

⁶ It is uncertain whether current stress testing regimes will apply to SunTrust or other super-regional banks under the Economic Growth, Regulatory Relief, and Consumer Protection Act. As related rulemakings have not been proposed by the Agencies, our comments are based on stress testing requirements currently in effect.

⁷ For example, a frontloaded credit loss pattern under CECL combined with a stress capital buffer based on the lowest quarter may result in higher than expected capital requirements.

We appreciate the opportunity to provide our comments on the notice of proposed rulemaking. Thank you for considering our views. If you have any questions, please contact me at 404-532-0774.

Sincerely,

A handwritten signature in dark ink, appearing to read "L. Allison Dukes", with a stylized, flowing script.

L. Allison Dukes
Chief Financial Officer